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No. 83-

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1983

STRICK CORPORATION,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED

1. Is a revenue ruling of the Internal Revenue Service entitled to dispositive weight unless "plainly contrary" to the Internal Revenue Code, as if it were a Treasury Regulation promulgated after public comment?

2. Was not the revenue ruling involved in this case unreasonable when it permitted the manufacturers excise tax to be collected according to a formula which discriminates against petitioner and all low-profit-margin manufacturers in a highly competitive industry despite a congressional aim to effect uniform taxation?

3. Should not the excise tax imposed by section 4061(a) of the Internal Revenue Code be collected according to the substance of a transaction involving related corporations, instead of according to the form of the transaction?

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Strick Corporation petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit entered in this case on August 2, 1983.[1]

OPINIONS BELOW

The opinion of the court of appeals (A15-A43) of which review is sought is reported at 714 F.2d 1194 (3d Cir. 1983). The opinions of the district court (A1-A10 and A12-A13) have not been officially reported.

1. Strick Corporation is a wholly owned subsidiary of Distribution International Corporation.

JURISDICTION

The judgment of the court of appeals (A46-A47) was entered on August 2, 1983. A timely petition for rehearing was denied on November 7, 1983 (A44-A45), and this petition is being filed within 90 days of that date.

The Court has jurisdiction to review the judgment of the court of appeals under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

The language of 26 U.S.C. §§4061(a)(1), 4216(b)(1) & (c), and 4217 and of Revenue Ruling 54-61 applicable to this case appears immediately after the text of this petition.

STATEMENT OF THE CASE

This petition involves a conflict in circuits as to the level of scrutiny to be applied to revenue rulings of the Internal Revenue Service. It asks the Court to review determinations by the Service, eventually upheld by the court below, which force Strick Corporation to pay the manufacturers excise tax imposed by section 4061(a) of the Internal Revenue Code at a higher rate than its more profitable competitors and at a more expedited schedule than those competitors which can obtain easy financing for the leasing of their products. The petition seeks, in other words, to enforce the congressional mandate that excise tax be neutral in its effect.

A. *Determination of the Constructive Sale Price*

During the period at issue (1972 through the first half of 1978) Strick manufactured trailers which it sold at retail, *i.e.*, directly to consumers. Thus, the excise tax imposed by section 4061(a) on the price at which a manufacturer sells trailers to wholesalers was levied on the "constructive sale price" determined under section 4216(b)(1): the lower of (i) the actual retail price or (ii)

"the highest price for which such articles are sold to wholesale distributors, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary." I.R.C. §4216(b)(1) (1976) (amended 1978).

The Commissioner's determination with respect to trailer constructive sale prices during the period at issue was set forth in Revenue Ruling 54-61, 1954-1 C.B. 259, which provided that the constructive sale price for truck and trailer bodies was equal to the greater of (i) 75% of the established retail price or (ii) the manufacturer's cost per body (the "cost-floor alternative"). In October 1978, after Congress amended section 4216(b)(1) of the Code to prohibit the Commissioner's use of the cost-floor alternative.

Strick's cost of manufacture during the period at issue was always greater than 75% of its established retail price and, therefore, it paid the tax on a constructive sale price equal to its cost per trailer. During this same period, the vertically integrated manufacturers who are Strick's primary competitors were entitled, with their lower costs, to use a constructive sale price equal to 75% of their established retail prices.

Because of intense competition in the trailer industry, retail prices of trailers sold by Strick and its primary competitors were substantially equivalent during the period at issue. Therefore, Strick always paid more tax per trailer than its competitors during this period.

Strick filed the present claim for credit in the amount of the difference between what it paid during the period at issue and what it would have paid if it had used the 75% method allowed its competitors. Strick applied the amount of the claimed credit against the liability shown on its excise tax returns for the final two quarters of 1978 and the first quarter of 1979.

1. *The Decision of the District Court*

The district court agreed with Strick that, given the intensely competitive nature of the trailer industry, the cost-floor alternative determined by the Commissioner was not, when applied to the facts of this case, a valid interpretation of section 4216(b)(1) of the Code and that it was, with respect to this industry, "contrary to the legislative intent of the excise tax in that it imposed a non-uniform tax among competitors, ultimately having a discriminatory impact upon high cost manufacturers such as Strick." (A6). Thus, the district court upheld Strick's claim.

2. *The Decision of the Court of Appeals*

On appeal, the court of appeals reversed the decision of the district court, holding that while Strick may have been subjected to a competitive disadvantage by the cost-floor alternative, the method determined in Revenue Ruling 54-61 was not "plainly contrary" to the statute. 714 F.2d at 1197 (A21).

B. *Transactions Between Sister Corporations Before Leasing*

Until 1974, trailers manufactured by Strick, a wholly owned subsidiary of Distribution International Corporation, were both sold and leased directly by Strick.

In 1974, Distribution reactivated another wholly owned subsidiary, Cotco Leasing Company, and from 1974 through 1978 (the years at issue here) all leasing of trailers manufactured by Strick was performed through Cotco.

For each calendar quarter of the years at issue, Strick paid excise tax as if transfers of trailers from itself to Cotco for leasing were taxable sales. In its return for the first quarter of 1979, Strick claimed a credit for an overpayment of tax for the years at issue. The basis of

the claim was that the tax had erroneously been paid in full at the time each trailer was transferred from Strick to Cotco; the tax should have been paid ratably as lease payments were received from lessees by Cotco, as provided in section 4217(b) or 4216(c) of the Code.

1. *The Decision of the District Court*

The district court agreed with Strick that because Cotco did not have any independent substance as an entity apart from Strick, the transactions between Strick and Cotco were not sales upon which the excise tax could be collected. Instead, it was the transactions with Cotco's lessees which were the proper subject of the tax.

However, the district court held that the transactions with Cotco's lessees constituted sales upon which the full amount of the tax was immediately due. Thus, the district court denied Strick's refund claim for credit.

Strick petitioned to open the judgment and demonstrate that even if the transactions with Cotco's lessees were sales, the tax was still collectible only on a ratable basis under section 4216(c) of the Code. The petition was denied in a memorandum opinion and order dated March 4, 1982.

2. *The Decision of the Court of Appeals*

On appeal, the court of appeals affirmed on a different basis from that used by the district court. It held that Strick and Cotco were strictly bound by the form which they chose for their transactions and, therefore, that the transactions between Strick and Cotco had to be treated as sales upon which the full excise tax amount was immediately due.

The court of appeals also concluded that the district court's factual finding concerning the substance of the transactions between Strick and Cotco was not entitled to the usual weight given factual determinations because the district court applied the wrong legal standard.

Thus, the court of appeals held that Cotco had substance enough that its transactions with Strick could be characterized as sales.

REASONS FOR GRANTING THE WRIT

A. *By Affording Exceptional Deference to the Revenue Ruling, the Court of Appeals Reached a Result on the Constructive Price Issue Which Was Clearly Unjust and Contrary to the Congressional Purpose of Uniform Taxation.*

In proposing the first predecessor of section 4216(b)(1), the House Committee on Ways and Means stated:

> Severe and justified criticism may be expected whenever one manufacturer is permitted to pay a lesser tax than his competitors.

H.R. Rep. No. 708, 72d Cong., 1st Sess. 33 (1932), *reprinted in* 1939-1 C.B. 457, 480 (pt. 2). It is such "severe and justified criticism" that Strick now asks this Court to examine and uphold.

From 1972 through the first half of 1978, Strick paid $4,758,957 more in manufacturers excise tax than it would have if it could have used the same method of tax computation enjoyed by its direct competitors during the same period. Therefore, the cost-floor alternative which subjected Strick to this gross inequity is an unreasonable exercise of the Commissioner's discretion under section 4216(b)(1) of the Code.

1. *The "Plainly Contrary" Standard Adopted by the Court of Appeals for Judging the Validity of the Commissioner's Discretion in this Case Is in Conflict with the Decisions of This Court and of Other Courts of Appeals.*

The court of appeals phrased its inquiry into Strick's attack on Revenue Ruling 54-61's application of the

cost-floor alternative in a manner calculated to cause Strick a substantial competitive disadvantage compared to its competitors — who already had a cost advantage, found as a fact by the district court — in the narrowest of terms:

> the issue is whether this competitive disadvantage makes the method *plainly contrary* to section 4216(b).

714 F.2d at 1197 (A21) (emphasis added). In other words, it gave the Revenue Ruling the weight of law.

By contrast, this Court had early recognized that a revenue ruling, unlike a treasury regulation adopted after public comment, is entitled to more limited weight. *See Bartels v. Birmingham*, 332 U.S. 126, 132 (1947); *Helvering v. New York Trust Co.*, 292 U.S. 455, 468 (1934). This limited weight was recognized even in the Introduction to the Cumulative Bulletin in which Revenue Ruling 54-61 is printed:

> Revenue Rulings reported in the Bulletin do not have the force and effect of Treasury Department Regulations (including Treasury Decisions) . . . .

1954-1 C.B. 1. Thus, the excessive deference paid by the court of appeals to this administrative interpretation is clearly contrary to the proper standard of review. *Cf. Commissioner v. Engle*, 52 U.S.L.W. 4033, 4038-39 (U.S. Jan. 10, 1984) (administrative position of Internal Revenue Service embodied in Proposed Regulations tested by standard of reasonableness, not by "plainly contrary" standard).

The limited review of Revenue Ruling 54-61 by the court of appeals in this case conflicts not only with early decisions of this Court, but also with the much higher level of scrutiny to which other circuits have more re-

more recently subjected the Commissioner's revenue rulings. Thus, in *Macey's Jewelry Corp. v. United States*, 387 F.2d 70 (5th Cir. 1967), an excise tax case, the court rejected the Commissioner's criteria, published in a revenue ruling, for determining the amount of the "finance charge" which would be excludable from the price upon which the tax was levied, holding that revenue rulings are "not authority having the force of law, to be automatically applied in each and every case." 387 F.2d at 72. Even where the Code expressly grants the Commissioner "discretion," the exercise of such discretion through a revenue ruling has been judged as to whether it is "reasonable discretion," and not as to whether it is plainly contrary to the Code. *Merchants Industrial Bank v. Commissioner*, 475 F.2d 1063, 1064 (10th Cir. 1973).[2]

Because the standard of review to be applied to determine whether a revenue ruling should be followed may have a great bearing on the question of whether that ruling will be sustained in the courts, and because the courts of appeals are divided on this important question, this Court should grant certiorari to resolve that question in this case.

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2. Other decisions from courts of appeals and the Court of Claims show much less deference to the Commissioner's revenue rulings than the court of appeals decision in this case. *E.g.*, *Propstra v. United States*, 680 F.2d 1248, 1256-57 (9th Cir. 1982); *Stahmann Farms, Inc. v. United States*, 624 F.2d 958, 960 (10th Cir. 1980); *Conway County Farmers Association v. United States*, 588 F.2d 592, 600 (8th Cir. 1978); *First National Bank v. Commissioner*, 546 F.2d 759, 761 (7th Cir. 1976) (per curiam), *cert. denied*, 431 U.S. 915 (1977); *Stubbs, Overbeck & Associates v. United States*, 445 F.2d 1142, 1146-47 (5th Cir. 1971); *Byrum v. United States*, 440 F.2d 949, 952-53 (6th Cir. 1971), *aff'd*, 408 U.S. 125 (1972); *St. Louis Bank for Cooperatives v. United States*, 624 F.2d 1041, 1050-51 (Ct. Cl. 1980) (per curiam).

2. *Adoption of an Overly Lenient Standard of Review Was Material in This Case Since It Led the Court of Appeals to an Unjust Result Not Intended by Congress.*

In Revenue Ruling 54-61, the Commissioner violated one of the "six fundamental tests" which Congress originally required the manufacturers excise tax to meet, namely that:

> The tax must be imposed uniformly and without discrimination.

H.R. Rep. No. 708, 72d Cong., 1st Sess. 31 (1932), *reprinted in* 1939-1 C.B. 457, 479 (pt. 2).[3] The drafters of the constructive price provision expected that the Commissioner would reach an understanding with each industry as to a nondiscriminatory method of tax computation. *Id.* at 37-38, *reprinted in* 1939-1 C.B. at 484 (pt. 2). Instead, the Commissioner chose — 22 years after the first enactment of the constructive price provision — to determine unilaterally a plainly discriminatory basis for tax computation in the highly competitive trailer industry.[4]

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3. As Congress later recognized, the cost-floor alternative, which naturally requires a costly and complex audit procedure to insure its correct application, also violates a second, "fundamental test," namely, that "[c]ertainty, both as to liability and amount, must be attainable in advance of the sale." *Id.*; *see* S. Rep. No. 95-1127, 95th Cong., 2d Sess. 3-5 (1978), *reprinted in* 1978-2 C.B. 369, 370-71.

4. Both the court of appeals and the Government relied heavily below on language in H.R. Rep. 708 which suggests, as one example of what could be a practical price construction method, "building up from cost of production." *Id.* at 33, 38, *reprinted in* 1939-1 C.B. at 480, 484 (pt. 2). However, this suggestion of one possible method was surely not intended to confer discretion upon the Commissioner to adopt it blindly regardless of harmful competitive effects.

As noted above, under the Commissioner's cost-floor alternative Strick must pay $4,758,957 more tax than it would under the 75% method allowed its competitors — even though Strick and its competitors charged virtually identical prices for virtually identical goods. This highly inequitable result is so out of harmony with the clear legislative intent behind the manufacturers excise tax, in general, and the constructive price provision, in particular, as to constitute an abusive, invalid exercise of the Commissioner's discretion.[5]

Only the intervention of this Court can prevent the final execution of this administrative abuse.

B. *The Decision Below on the Intercorporate Transactions Issue Raises an Important Question with Respect to the Collection of the Excise Tax and Resolves It in a Manner in Conflict with a Decision of the Second Circuit and with the Published Position of the Internal Revenue Service.*

The decision of the court of appeals is in direct conflict with the decision of the Second Circuit in *Hoffman Motors Corp. v. United States*, 473 F.2d 254 (2d Cir. 1973), holding that a taxpayer is permitted to demon-

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5. When Congress finally focused on this issue, it flatly prohibited the Commissioner's use of the cost-floor alternative because of its discrimination against low-profit-margin manufacturers who sell at retail. S. Rep. No. 95-1127, 95th Cong., 2d Sess. 3 (1978), *reprinted in* 1978-2 C.B. 369, 371. Although the legislative history to this amendment states that "no inference" be drawn from it with respect to controversies such as this case, the fact of the amendment and the congressional finding as to the discriminatory impact of the Commissioner's method can hardly be ignored. Indeed, this amendment is simply a recent example of Congress' continuing concern over and attempts to correct the discriminatory impact of the manufacturers excise tax. *See, e.g.*, S. Rep. No. 91-1444, 91st Cong., 2d Sess. 20-23, 25-26 (1970), *reprinted in* 1971-1 C.B. 574, 584-88; H.R. Rep. No. 481, 85th Cong., 1st Sess. 21-22 (1957), *reprinted in* 1958-3 C.B. 372, 392-93; H.R. Rep. No. 1860, 75th Cong., 3d Sess. 10, 67 (1938), 1939-1 C.B. 728, 734-35, 776 (pt. 2).

strate that the excise tax imposed by section 4061(a) should be collected according to the substance of a transaction involving related corporations, and not necessarily according to the form of the transaction.

The strict application of the so-called "form vs. substance" doctrine adopted by the court of appeals in this case is also contrary to the position adopted by the Internal Revenue Service in several published rulings. *E.g.*, Rev. Rul. 59-299, 1959-2 C.B. 253; Rev. Rul. 59-163, 1959-1 C.B. 353. In Revenue Ruling 59-299, the Internal Revenue Service ruled that there was no taxable "sale" when goods, subject to the tax imposed by section 4061(a)(2) of the Internal Revenue Code, were transferred from one partnership to another partnership, each of which was owned in equal proportions by the same two individuals. This ruling, which provides direct support for Strick's position that an entity recognized for income tax purposes is not necessarily recognized for excise tax purposes, was distinguished by the court of appeals on the ground that the related entities involved in the ruling were not corporations.

By carrying over into the excise tax the income tax doctrine that taxpayers may not challenge the imposition of tax according to the form of a transaction involving related corporations, the court of appeals applied the doctrine beyond its proper boundaries. Under the income tax, a "corporation" is a special type of entity to which special rules apply. Substantial income tax consequences flow from a taxpayer's choice of business form — *e.g.*, proprietorship, partnership, trust, corporation — and great respect for business form is warranted when the Commissioner asserts that such form should control with respect to the income tax unless there is reason to pierce the corporate shell.

However, for excise tax purposes it is virtually always immaterial what form of entity is chosen for a business operation. An excise tax is imposed on the occur-

rence of an event, which, in the case at hand, is a sale between parties. For purposes of imposing the tax, it is irrelevant whether either party is a "corporation." Rather, it is important to characterize the seller as a "manufacturer," "producer," or "importer." *E.g.*, I.R.C. §4061(a)(1) (1976) (amended 1978). Thus, a focus on corporate form instead of on the substance of the transactions to which the excise tax applies is inappropriate and may lead to serious inequity, as it did in this case. Here, according to the decision of the court of appeals, the simple placement of a shell subsidiary corporation between a manufacturer and the lessees of its products triggers the immediate collectibility of the full amount of tax, where before there had been ratable collection as lease payments were received.

For these reasons, the Second Circuit's flexible approach in *Hoffman Motors Corp.* is the better approach, being more in keeping with the structure and intended operation of the manufacturer's excise tax. And, given that it is immaterial for purposes of the excise tax whether the taxpayer is a corporation or other type of entity, the distinction drawn by the court of appeals between this case and Revenue Ruling 59-299 is unwarranted.

CONCLUSION

For each and all of the foregoing reasons, a writ of certiorari should be granted.

Respectfully submitted,

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STATUTORY PROVISIONS INVOLVED

During the years at issue, section 4061(a)(1) of the Internal Revenue Code, 26 U.S.C. § 4061(a)(1) (1976) (amended 1978), provided:

> § 4061. Imposition of tax
> (a) Trucks, buses, tractors, etc.
> (1) Tax imposed
> There is hereby imposed upon the following articles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof) sold by the manufacturer, producer, or importer a tax of 10 percent of the price for which so sold, except that on and after October 1, 1979, the rate shall be 5 percent —
>
> Automobile truck chassis.
> Automobile truck bodies.
> Automobile bus chassis.
> Automobile bus bodies.
> Truck and bus trailer and semitrailer chassis.
> Truck and bus trailer and semitrailer bodies.
> Tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.
>
> A sale of an automobile truck, bus, truck or bus trailer or semitrailer shall, for the purposes of this subsection, be considered to be a sale of a chassis and of a body enumerated in this subsection.

During the years at issue, section 4216(b)(1), (c) of the Internal Revenue Code, 26 U.S.C. § 4216(b)(1), (c) (1976) (amended 1978), provided:

> § 4216. Definition of price
>
> . . . .

(b) Constructive sale price

(1) In general

If an article is —

(A) sold at retail,

(B) sold on consignment, or

(C) sold (otherwise than through an arm's length transaction) at less than the fair market price,

the tax under this chapter shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary. In the case of an article sold at retail, the computation under the preceding sentence shall be on whichever of the following prices is the lower: (i) the price for which such article is sold, or (ii) the highest price for which such articles are sold to wholesale distributors, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary. This paragraph shall not apply if paragraph (2) applies.

. . . .

(c) Partial payments

In the case of —

(1) a lease (other than a lease to which section 4217(b) applies),

(2) a contract for the sale of an article wherein it is provided that the price shall be paid by installments and title to the article sold does not pass until a future date notwithstanding partial payment by installments,

(3) a conditional sale, or

(4) a chattel mortgage arrangement wherein it is provided that the sales price shall be paid in installments,

there shall be paid upon each payment with respect to the article a percentage of such payment equal to the rate of tax in effect on the date such payment is due.

During the years at issue, section 4217 of the Internal Revenue Code, 26 U.S.C. § 4217 (1976) (amended 1978), provided:

§ 4217. Leases

(a) Lease considered as sale

For purposes of this chapter, the lease of an article (including any renewal or any extension of a lease or any subsequent lease of such article) by the manufacturer, producer, or importer shall be considered a sale of such article.

(b) Limitation on tax

In the case of any lease described in subsection (a) of an article taxable under this chapter, if the tax under this chapter is based on the price for which such articles are sold, there shall be paid on each lease payment with respect to such article a percentage of such payment equal to the rate of tax in effect on the date of such payment, until the total of the tax payments under such lease and any prior lease to which this subsection applies equals the total tax.

(c) Definition of total tax

For purposes of this section, the term "total tax" means —

(1) except as provided in paragraph (2), the tax computed on the constructive sale price for such article which would be determined under section 4216(b) if such article were sold at retail on the date of the first lease to which subsection (b) applies; or

(2) if the first lease to which subsection (b) applies is not the first lease of the article, the

tax computed on the fair market value of such article on the date of the first lease to which subsection (b) applies.

Any such computation of tax shall be made at the applicable rate specified in this chapter in effect on the date of the first lease to which subsection (b) applies.

(d) Special rules

(1) Lessor must also be engaged in selling

Subsection (b) shall not apply to any lease of an article unless at the time of making the lease, or any prior lease of such article to which subsection (b) applies, the person making the lease or prior lease was also engaged in the business of selling in arm's length transactions the same type and model of article.

(2) Sale before total tax becomes payable

If the taxpayer sells an article before the total tax has become payable, then the tax payable on such sale shall be whichever of the following is the smaller:

(A) the difference between (i) the tax imposed on lease payments under leases of such article to which subsection (b) applies, and (ii) the total tax, or

(B) a tax computed, at the rate in effect on the date of the sale, on the price for which the article is sold.

For purposes of subparagraph (B), if the sale is at arm's length, section 4216(b) shall not apply.

(3) Sale after total tax has become payable

If the taxpayer sells an article after the total tax has become payable, no tax shall be imposed under this chapter on such sale.

Revenue Ruling 54-61, 1954-1 C.B. 259, provides:

Regulations 46, Section 316.50: Scope of tax.

Sales by a manufacturer of new truck or truck trailer bodies produced from new or salvaged materials to replace bodies which have been wrecked are taxable under section 3403(a) of the Internal Revenue Code.

Advice is requested concerning the application of the tax under section 3403(a) of the Internal Revenue Code to the sale by a manufacturer of new truck or truck trailer bodies produced from new or salvaged materials furnished by the manufacturer to replace bodies which have been wrecked.

Under section 3403(a) of the Code, tax at the rate of 8 percent is imposed on the sale by the manufacturer of automobile truck chassis, automobile truck bodies, truck and bus trailer and semitrailer chassis, and truck and bus trailer and semitrailer bodies.

It is held that where a manufacturer furnishes either new or salvaged materials and produces new truck or truck trailer bodies to replace bodies which have been wrecked, the sale of the bodies by the manufacturer is subject to tax under section 3403(a) of the Code. However, under the provisions of section 3443(a) of the Code, a credit may be allowed to a manufacturer in the amount of excise tax which has been paid on any new parts purchased and used by him in the manufacture of bodies with respect to which tax has been reported or paid. (See section 316.204, Regulations 46.)

Sales by a manufacturer of truck or truck trailer bodies to dealers or others for resale are considered sales at wholesale. Where the manufacturer's vendee purchases such a body for use and not for resale, the transaction is considered a sale at retail.

The following sets forth the method of computing the tax with respect to sales by manufacturers of truck or truck trailer bodies at wholesale, wholesale and retail, and retail only.

With respect to sale of bodies at wholesale, the tax imposed by section 3403(a) of the Code should be based on the wholesale price subject to the following adjustments provided by section 3441(a) of the Code. To the wholesale price there should be added any charge for the transportation or delivery of the bodies; and there should be excluded any expenses actually incurred by the manufacturer (1) in effecting delivery of the bodies to the purchasers, (2) for installation of the completed bodies on chassis, (3) for insuring shipments to the purchasers, and the amount of tax if not entered on the invoice as a separate charge.

Under the authority of section 3441 (b)(1) of the Code, the tax on retail sales of bodies by a manufacturer who also sells such articles at wholesale, is to be based upon his highest established wholesale price to independent dealers, subject to the same adjustments herein before stated in connection with sales at wholesale.

The tax on sales of bodies by a manufacturer who sells only at retail is to be computed, under the authority of section 3441(b)(1) of the Code, on the price for which such articles are sold by manufacturers or producers in the ordinary course of trade as determined by the Commissioner. Such determination has been made with respect to truck or truck trailer bodies and it has been found to represent 75 percent of the established retail price, subject to adjustment with respect to the above-mentioned additions and exclusions provided by section 3441 (a) of the Code. This results in the adjusted price on which the tax is to be based. If the tax is not included in the retail price, it is to be computed at 8 percent of the adjusted price. Where the tax is included in the retail price, it may be computed at two twenty-sevenths (8/108) of the adjusted price in order to provide for the exclusion of the tax from the

price on which it is based. In any case where the tax base determined in this manner with respect to sales by a manufacturer who sells only at retail results in a price which is less than the manufacturer's cost of the body when in condition ready for delivery to the purchaser, the tax should be computed at 8 percent of such cost.

It is further held that where a manufacturer merely replaces certain parts of a used truck or truck trailer body belonging to a customer, such operation is considered to constitute a repair operation and the tax imposed under section 3403(a) of the Code does not apply to the amount charged for such repairs. However, the manufacturer is liable for tax under section 3403(c) of the Code with respect to any taxable parts or accessories of his manufacture or which were purchased by him tax-free for further manufacture, which are sold to the customer in connection with the repair operation.

APPENDIX

IN THE UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF PENNSYLVANIA

STRICK CORPORATION	:	
	:	
VS.	:	C.A. NO. 80-1433
	:	
THE UNITED STATES	:	FILED AUG. 24, 1981

MEMORANDUM OPINION AND ORDER

WEINER, J. AUGUST 24, 1981

This is an action for recovery of federal manufacturer's excise taxes which are alleged to have been erroneously assessed and collected from plaintiff Strick Corporation (Strick) by the Internal Revenue Service (IRS) pursuant to 26 U.S.C. §4216(b). Strick challenges the "cost-floor alternative" method set forth in Revenue Ruling 54-61, 1954-1 C.B. 259, and used by the IRS in computing the excise tax due on Strick's truck trailers for the first quarter of 1972 through the first quarter of 1978, and seeks recovery of $4,758,957.00, plus interest. The defendant has counterclaimed for the same amount since Strick, pursuant to §6416(f) of the IRS Code, took a credit for these taxes on subsequent excise tax returns for the third and fourth quarters of 1978 and the first quarter of 1979. In addition, Strick advances a claim for a credit of $3,195,591.00 representing excise tax payment, plus interest,[1] allegedly erroneously computed and collected on certain lease transactions between Strick and Cotco Leasing Co., (Cotco), an affiliated corporation.

Trial was held before this court, sitting without a jury. For the reasons to follow, judgment is entered in favor of Strick and against the IRS in the matter of ex-

1. $2,976,654.00 in tax and $218,937.00 in interest.

cise tax computation and judgment for the IRS and against Strick in the leasing issue (Cotco).

The dispute before the court is two-fold. The first issue is the computation of the correct price on which the 10% manufacturer's excise tax authorized by §4061(a)[2] of the Internal Revenue Code (Code) should be imposed. The second issue is whether the business dealing between Strick and Cotco constituted a sale subject to excise taxes under that same section of the Code.

Generally, the excise tax is based on the price at which a taxable item is sold by the manufacturer in the ordinary course of trade. However, §4216(b)[3] of the

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2. 26 U.S.C. §4061 provides:

(a) Trucks, buses, tractors, etc. —

(1) Tax imposed. — There is hereby imposed upon the following articles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof) sold by the manufacturer, producer, or importer a tax of 10 percent of the price for which so sold, except that on and after October 1, 1984, the rate shall be 5 percent —

Automobile truck chassis.
Automobile truck bodies.
Automobile bus bodies.
Truck and bus trailer and semitrailer chassis.
Truck and bus trailer and semitrailer bodies.
Tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.

A sale of an automobile truck, bus, truck, or bus trailer or semitrailer shall, for the purposes of this subsection, be considered to be a sale of a chassis and of a body enumerated in this subsection.

3. 26 U.S.C. §4216 provides in pertinent part:

(b) Constructive sale price. —

(1) In general. — If an article is —

(A) sold at retail,

(B) sold on consignment, or

(C) sold (otherwise than through an arm's length transaction) at less than the fair market price,

the tax under this chapter shall (if based on the price for which the article is sold) be computed on the price for

Code provides for a constructive sale price if taxable articles are sold by a manufacturer or importer to someone other than a wholesale distributor. Under §4216(b)(1), if a manufacturer or importer sells a taxable article at retail, the constructive sale price is the lower of (1) the price for which the article was sold, or (2) the highest price at which such articles are sold to wholesale distributors as determined by the Treasury Department.

In Revenue Ruling 54-61, 1954.1 C.B. 259 the IRS sets forth the "cost-floor alternative" of computing the excise tax. Under the ruling, if a manufacturer sells taxable trucks at retail, the constructive price at which such items are sold to wholesale distributors is considered to be 75% of the "established retail price." The "established retail price" is the price for which a manufacturer sells, or offers to sell, an item for use by an independent purchaser for use and not for resale. However, if a manufacturer's actual cost of making and selling an item is greater than the constructive sale price of 75% of the "established retail price," then it is that cost, rather than

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which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary. In the case of an article sold at retail (other than an article the sale of which is taxable under section 4061(a)), the computation under the preceding sentence shall be on whichever of the following prices is the lower: (i) the price for which such article is sold, or (ii) the highest price for which such articles are sold to wholesale distributors, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary. In the case of an article the sale of which is taxable under section 4061(a) and which is sold at retail, the computation under the first sentence of this paragraph shall be a percentage (not greater than 100 percent) of the actual selling price based on the highest price for which such articles are sold by manufacturers and producers in the ordinary course of trade (determined without regard to an individual manufacturer's or producer's cost). This paragraph shall not apply if paragraph (2) applies.

the 75% of the sale price which is used to compute the constructive price for purposes of the applicable excise tax. This is the "cost-floor alternative." There is no dispute that the cost of manufacturing plaintiff's truck trailers exceeded 75% of the final retail sales price. The "cost-floor alternative" was therefore used in computing plaintiff's tax liability.

Computation of the excise tax based on the constructive sales price (75% of "established retail price") poses no competitive problem for plaintiff because prices, being competitive, are relatively the same between Strick and its competitors, and by imposing tax on the sales price, all manufacturers pay relatively the same tax. But as plaintiff argues, the so-called "cost-floor alternative" puts a high cost manufacturer, such as plaintiff,[4] at a competitive disadvantage with respect to its competitors, who produce their truck trailers at lower cost than plaintiff's. This is due to the highly competitive nature of the truck trailer business in that the method operates to increase plaintiff's tax in years when business is bad and sales are down, for in those years the result is a higher cost per unit, and thus an increased tax base. Accordingly Strick paid a higher excise tax in years of lower profitability.

The cost-floor method was developed administratively by the IRS. Congress has never enacted the cost-floor rule into law. The effect of the cost-floor alternative has been to discriminate against a low profit margin

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4. Plaintiff is primarily engaged in the manufacture of truck and truck trailer bodies, and was so engaged during the period for which the challenged tax collections were made. Strick is a high cost manufacturer. Strick purchases extruded aluminum sections and sheet steel, cuts them to length and makes finished pieces. Strick has a plant which manufactures wooden floors and manufactures approximately 75% of the flooring it needs. The other items used in manufacturing, such as wheels, tires, plywood, brakes, axles, landing gear, paint, duals, hinges, and hardware of all types, are purchased from third parties.

manufacturer and to impose a non-uniform tax among competitors. While the governing statute grants the IRS the exclusive authority to determine the constructive sales price,[5] this does not foreclose review of the determination of IRS. Bearing in mind the deference owed to the expertise of the IRS[6] we must still conclude that the cost-floor method as applied to the facts *sub judice* was not a proper method by which to compute the constructive sales price.

When the constructive sale price provisions were adopted, Congress clearly stated that these provisions be "imposed and administered uniformly and without discrimination. Each member of a competitive group must pay upon substantially the same basis as all his competitors, even though his sales methods may differ." House Report No. 708, 72nd Congress 1st Session, Mar. 8, 1932, pp. 37-38. Moreover, in establishing a uniform price base for a constructive sale price for the auto industry the Congress in enacting the Excise, Estate and Gift Tax Adjustment Act of 1970 stated that "it is expected and intended that the tax will be neutral with regard to competition within the auto industry." Sen. Rep. No. 91-1444, 91st Cong. 2nd Sess., *reprinted in* 19 U.S. Code Cong. & Ad. News at 5710. Congress thereby reiterated its concern that the excise tax be a "neutral" tax and not economically disadvantage a member of a com-

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5. See note 3 *supra* for text of 26 U.S.C. 4216(b)(1). In addition it has been held that the language of 4216 grants to IRS authority to determine constructive sales prices and does not appear to preclude the exercise of some discretion in deciding exactly how such determination will be made. *Columbia Products Co. v. United States*, 404 F.Supp. 276, 282 (D.S.C. 1975).

6. In similar statutory settings the courts have applied the rule that the Commissioner's interpretation of a statute which delegates to him authority to administer its provisions is to be upheld unless his interpretation is plainly contrary to the statute or is unreasonable. *Commissioner v. South Texas Co.*, 33 U.S. 496, 501 (1948); *United States v. Correll*, 389 U.S. 299 (1967); *Whattoff v. United States*, 355 F.2d 473 (8th Cir. 1966).

petitive group. Therefore, the use by the IRS of the cost-floor alternative in the trailer industry was contrary to the legislative intent of the excise tax in that it imposed a non-uniform tax among competitors, ultimately having a discriminatory impact upon high cost manufacturers such as Strick.

While the courts have consistently approved the use by the IRS of the cost-floor method of determining excise taxes or their regulations, they have done so by either concluding that its use was not improper or unreasonable under the circumstances of the case before them, or that it would achieve the uniformity contemplated by the congressional intent of the statute. *See, Commissioner v. South Texas Co.*, 333 U.S. 496, 501 (1948); *Whattoff v. United States*, 355 F.2d 473 (8th Cir. 1966); *Hamrick v. United States*, 585 F.2d 1015 (Ct. Cl. 1978); *Callis-Thompson, Inc. v. United States*, 45 A.F.T.R. 2d 80-1820 (Del., 1980). As we have noted, that is not the situation in the case *sub judice*, as imposition of the cost-floor alternative does not result in a uniform impact upon the truck-trailer industry.

In 1978 Congress amended §4216(b) to prohibit the use of manufacturers' cost in determining the constructive sale price to ensure that the tax be uniformly imposed. This court recognizes that Congress explicitly stated that no inference, regarding the validity of the cost floor rule, be drawn from that legislative action. Yet, as did Congress, this court must nonetheless conclude, based upon our own independent analysis, uninfluenced by the 1978 Congressional amendments to the excise tax section of the Code, that the cost-floor alternative as applied to high cost manufacturers in an extremely competitive industry, such as the trailer industry, creates a situation which circumvents the legislative intent of the act which created the excise tax. Therefore, the cost-floor alternative method of computing the plaintiff's federal excise tax liability is an improper method under the facts and circumstances of this case.

STRICK AND COTCO LEASING ISSUE

Plaintiff contends that the sales of truck trailers by it to Cotco do not constitute sales subject to manufacturer's excise taxes under section 4061 of the Internal Revenue Code (Code). Under the circumstances of the business dealing described below this court finds that no actual sale of the trailers between plaintiff and Cotco took place, but only a bookkeeping transaction. The taxable event occurs when the trailer passes to the first independent lessee or purchaser, and we do find that there was a sale between plaintiff and Cotco's "lessees".

Strick and Cotco are wholly owned subsidiaries of the same holding company, Distribution International Corporation (Distribution), hence there is an identity of ownership, since Distribution owns 100% of both companies. Cotco has no employees, no place of business and no physical existence beyond that which Strick provides it. All of Cotco's functions are performed by Strick personnel. All the customers come to Cotco via Strick. Strick ships the trailers directly to its customers while Cotco maintains its own bank accounts and plaintiff's lessees make their payments directly to Cotco. Cotco then transfers the money from its bank account to Strick. The transfer of plaintiff's trailers to Cotco was solely for financing purposes. In 1974 plaintiff needed outside financing, Cotco was set up to meet the requirements of plaintiff's lenders, not to avoid taxes. Based on the above facts this court finds that Cotco does not have sufficient economic substance to be treated as a separate tax entity. Therefore the transactions between plaintiff and Cotco should be seen as purely between plaintiff and the subsequent purchaser from Cotco and the excise tax is due on the value of the entire "lease" when the "lease contract" is incurred rather than, as plaintiff contends, on the amount of each lease payment when and as the lease payments are received.

Both plaintiff and defendant stipulated and agreed to the fact that Cotco would obtain money from banks to buy the trailers from Strick for Strick's customers. "[Cotco] would then pay the money over to Strick in return for the trailer to be leased." Page 2, Second Stipulation of Facts. This "leasing" arrangement was nothing more than a form of deferred payment by the customer for its purchase of a trailer. Cotco was set up "for the purpose of securing financing" for the user-customers. *Id.* Cotco was merely a vehicle by which a customer could obtain financing for the purchase of a trailer and spread its payments over time under the guise of a "lease". For these reasons the court views the transactions between Cotco and Strick's customers as sales and not leases. Thus 26 U.S.C. §4217 — Leases, is not applicable in determining manufacturer's excise taxes in the case *sub judice*.

The issue before the court revolves around the term "sale". Section 316.1(f) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954-2 47, 59-163, 1959-1 Cum. Bul. 353; 59-298, 1959-1 Cu. Bul. 252 as cited in Revenue Rulings, define "sale" "as an agreement whereby the seller transfers the property (that is, the title or substantial incidents of ownership) on goods to the buyer for a consideration called the price, which may consist of money, services or other goods." *Id.* at 252.

The factual situation presented in Revenue Ruling 59-163, 1959-1 Cu. Bul. 353 was very similar to that in the case *sub judice*. There, the officers and shareholders of M Corporation formed N Corporation, to handle all of its domestic sales. The two companies had the same shareholders, and the records and books were maintained by the same employees in the same office space. Articles were not delivered to N, but directly to customers from M. Journal entries were made to account for the transactions between M & N. The Revenue Ruling held

that there was no actual sale of articles by M to N "but only a bookkeeping transaction, and the taxable sale or transaction occurs when title to the articles passes to the first independent distributor or jobber, ..."

Both Revenue Rulings 59-298 and 59-299, 1959-2 Cum. Bul. 253, elaborate on the definition of "sale" by requiring the involvement of two separate parties. Revenue Ruling 59-299, *supra*, further clarifies the issue. "In order for a transfer of goods to constitute a sale, it must be between two separate individuals or entities. Accordingly, a person may not sell to himself." *Id.* at 254. The Ruling sets forth a situation whereby A, an individual, owns two companies, one of which manufactures trailers, the other leases those trailers. The manufacturing company transfers the trailers for a fair market price to the leasing company who in turn leases to the public. The Revenue Ruling held that since both the manufacturing company and the leasing company are owned by the same person, the transfers of trailers between the two companies does not constitute a sale. *Id.* Here, both Strick and Cotco are wholly owned by the same individual, Distribution. The Revenue Ruling further stated that under sections 4216 or 4217 of the Code, the subsequent lease of the trailers is subject to the tax imposed by section 4061(a)(2) of the Code.

In *Kin-Septic Co. v. United States*, 64 F.Supp. 142 (Ct. Cl. 1946), the court held that the Internal Revenue could treat two corporations as one organization for purposes of computing the manufacturer's excise tax where the same stockholder managed and owned both corporations and both corporations used the same employees and premises.

Kin-Septic Co., relied on the rationale of *Ayer Co. v. United States*, 38 F.Supp. 284 (Ct. Cl. 1941), and the cases cited therein. Ayer sold its products to Vita-Ray Corporation, who in turn sold to the retail trade. The *Ayer* court held that Vita-Ray Corporation was consid-

ered a mere shell, because its activities were carried on by Ayer's employees, its officers and board of directors were the same as Ayer's. It had no offices other than Ayer's and Ayer owned all of its capital stock. The court disregarded Vita-Ray's existence and treated the sales it made as having been made by Ayer. Similarly, Cotco's existence and Strick's sales to Cotco should be disregarded. Strick's liability for excise taxes should be based upon the value of the entire "lease agreement" it arranged through Cotco when it is entered into.

Another Revenue Ruling, 75-130, 1975-1 Cum. Bul. 347, with facts similar to those of the case *sub judice*, addressed another aspect of the "sale" issue, that of the sale's purpose. There, a manufacturer of truck bodies who directly negotiated the prices, specifications, etc. with its customer, invoiced the sales to a truck dealer, who in turn resold the trucks to the manufacturer's customer in order that the customer be able to use the financing resources of the truck dealer. The issue the ruling addresses is whether the manufacturer-dealer sale was a sale for purposes of computing the manufacturer's excise tax. The Ruling held that it was not since "[t]he only reason it takes the form of a sale of a dealer is for financing purposes." Under the circumstances, "the sale is in substance a sale to the consumer and is, therefore, a sale at retail for purposes of computing the manufacturers excise tax." Therefore the manufacturer's excise tax should be paid by Strick for the sale by Cotco to Strick's customers, pursuant to section 4216(b)[7] of the Code.

The foregoing constitutes this court's findings of fact and conclusions of law in accordance with Rule 52(a) of the Federal Rules of Civil Procedure.

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7. See note 3 *supra* for text of §4216(b).

IN THE UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF PENNSYLVANIA

STRICK CORPORATION	:	
	:	
VS.	:	C.A. NO. 80-1433
	:	
THE UNITED STATES	:	

AUGUST 24, 1981

ORDER

Judgment is entered in favor of plaintiff and against the defendant on the excise tax computation (cost floor alternative) issue in the amount of $4,758,957.00, and in favor of the defendant and against the plaintiff on the leasing (Cotco) issue.

IT IS SO ORDERED.

CHARLES R. WEINER

IN THE UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF PENNSYLVANIA

STRICK CORPORATION	:	
	:	
VS.	:	C.A. NO. 80-1433
	:	
THE UNITED STATES	:	

MEMORANDUM OPINION AND ORDER

WEINER, J. MARCH 4, 1982

On August 24, 1981, this Court issued an Opinion and Order in the above-captioned case entering judgment in favor of the plaintiff with respect to one claim and in favor of the defendant with respect to plaintiff's second claim. Plaintiff now moves this Court, pursuant to Rules 52(b) and 59(a)(2) and (e), respectively, to reopen that judgment, to hear additional testimony and to enter a new judgment granting plaintiff the full amount of the relief requested in the complaint or, alternatively, to order a new trial limited to the consideration of plaintiff's unsuccessful claim.

For the reasons which follow, plaintiff's motions are denied.

Plaintiff brought suit to recover federal manufacturer's excise taxes which were alleged to have been erroneously assessed and collected from plaintiff Strick Corporation (Strick) by the Internal Revenue Service (IRS) pursuant to 26 U.S.C. §4216(b). Strick unsuccessfully sought a credit of $3,195,591.00 representing excise taxes, plus interest, which the IRS allegedly erroneously computed and collected on certain "lease" transactions between Strick and its affiliate, Cotco Leasing Co. This claim turned on the issue of whether the transfer of truck trailers from Strick to Cotco constituted a sale subject to excise taxes under Section 4061(a) of the Internal

Revenue Code. *See*, Opinion dated August 24, 1981 at 2-3. Plaintiff contended that its sales of truck trailers to Cotco constituted leases and not "sales" for federal excise tax purposes.

This Court determined that Cotco did not have sufficient economic substance to be treated as a separate tax entity; that, therefore, the transactions between Strick and Cotco should be seen as purely between plaintiff and the subsequent purchasers from Cotco and that those transactions were sales and not leases. *See*, Opinion at 8-10.

In its present motions plaintiff asserts that "there is sufficient evidence already in the record, and that the law clearly provides that the Cotco-lessee transaction is a lease for federal excise tax purposes. . . ." (Plaintiff's motions under Rules 52(b) and 59(a)(2) and (e) at 2.) Plaintiff's contention was examined and fully discussed in our August 24th Opinion. *See*, Opinion at 8-14. Accordingly, plaintiff's dissatisfaction with the Court's judgment cannot be founded on our failure to consider its argument that the transfer of trailers from Cotco to its "lessees" were leases and not sales. Rather, plaintiff's disappointment lies in the fact that we disagreed with its interpretation of the law.

Alternatively plaintiff moves for a new trial for the purpose of introducing additional evidence to support its position with respect to the "Cotco-lessee" issue. However, plaintiff had every opportunity to present all pertinent evidence at the trial. No new or after discovered evidence has been brought to the Court's attention indicating that a new trial is necessary.

Accordingly, having reviewed plaintiff's motions under Rules 52(b) and 59(a)(2) and (e) and accompanying brief, we affirm our Opinion and Order of August 24, 1981 and deny plaintiff's motions.

IN THE UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF PENNSYLVANIA

STRICK CORPORATION	:	
	:	
VS.	:	C.A. NO. 80-1433
	:	
THE UNITED STATES	:	

MARCH 4, 1982

ORDER

The motions of the plaintiff to reopen the judgment or for a new trial are DENIED.

IT IS SO ORDERED.

CHARLES R. WEINER

STRICK CORPORATION,
Appellant/Cross-Appellee,
v.
UNITED STATES of America,
Appellee/Cross-Appellant.

Nos. 82-1272, 82-1273.

United States Court of Appeals,
Third Circuit.

Argued June 9, 1983.
Decided Aug. 2, 1983.

Mervin M. Wilf (argued), Philadelphia, Pa., for appellant/cross-appellee.

Glenn L. Archer, Jr., Asst. Atty. Gen., Michael L. Paup, Robert T. Duffy, Laurie A. Snyder (argued), Tax Div., Dept. of Justice, Washington, D.C., for appellee/cross-appellant.

Before SEITZ, Chief Judge, SLOVITER, Circuit Judge, and SAROKIN, District Judge.*

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* Hon. H. Lee Sarokin, United States District Judge for the District of New Jersey, sitting by designation.

OPINION OF THE COURT

SAROKIN, District Judge.

The cross appeals before the court in this matter involve when the federal manufacturer's excise tax should be imposed and the proper method for computing the tax. Appellant and cross-appellee Strick Corporation ("Strick") appeals from a judgment of the district court which denied its claim for a refund of an alleged overpayment of the excise tax, plus interest, during all calendar quarters of 1974 through 1978. The taxpayer claimed below that transfers of its products between itself and a related corporation for a fair market price were not sales within the meaning of section 4061(a) of the Internal Revenue Code of 1954 (the "Code"). Appellee and cross-appellant United States appeals from that part of the same judgment which invalidated the so-called "cost-floor alternative" method of computing the excise tax and upheld Strick's claim of a tax credit for overpayment of tax, plus interest, from the beginning of 1972 through the first quarter of 1978.

We affirm the decision of the district court denying the taxpayer's refund claim in connection with transfers to the related corporation, but on a ground different from that relied upon below. We reverse the determination of the court below that the cost-floor method of computation is invalid.

I. THE GOVERNMENT'S APPEAL-THE COST-FLOOR ALTERNATIVES

Strick is a Pennsylvania corporation which engages principally in the manufacture of truck and truck trailer chassis and bodies. As such, pursuant to section 4061(a)

of the Code, it is subject to a manufacturer's excise tax of 10% of the price for which it sells its products.[1]

During the years 1972 to 1978 inclusive, Strick sold substantially all of its truck and trailer bodies directly to user-consumers ("at retail"). Under these circumstances, the manufacturer's excise tax is computed on a constructive wholesale sale price, "as determined by the Secretary."[2] Regulations issued pursuant to the statute

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1. Section 4061(a) of the Code provides in pertinent part:

(1) Tax imposed.—There is hereby imposed upon the following articles . . . sold by the manufacturer, producer, or importer a tax of 10 percent of the price for which so sold, . . .

Automobile truck chassis.

Automobile truck bodies.

* * * * * *

Truck and bus trailer and semitrailer chassis.

Truck and bus trailer and semitrailer bodies.

Tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.

A sale of an automobile truck, bus, truck or bus trailer or semitrailer shall, for the purposes of this subsection, be considered to be a sale of a chassis and of a body enumerated in this subsection.

26 U.S.C. §4061(a) (Supp. V. 1981).

2. During the relevant time period, the statute provided:

(1) If an article is—

(A) sold at retail,

(B) sold on consignment, or

(C) sold (otherwise than through an arm's length transaction) at less than the fair market price,

the tax under this chapter shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary. In the case of an article sold at retail, the computation under the preceding sentence shall be on whichever of the following prices is the lower: (i) the price for which such article is sold, or (ii) the highest price for which such articles are sold to wholesale distributors, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary. This paragraph shall not apply if paragraph (2) applies.

provide that in the absence of an established bona fide practice of selling articles to wholesale distributors, "a fair market price will be determined by the Commissioner." 26 C.F.R. §148.1-5 (1982). The price thus determined may not exceed the actual retail price of the article. *Id.* In a revenue ruling issued in 1954, the IRS determined that the constructive wholesale price would be the higher of 75% of the retail price of the truck or trailer body or the manufacturer's costs of manufacturing ("the cost-floor alternative"). Rev.Rul. 54-61, 1954-1 C.B. 259. It is undisputed that Strick is a high-cost manufacturer and that during the 1972-1978 period, its manufacturing costs exceeded 75% of the retail price. Strick therefore paid excise tax based on its cost of manufacture during this period.

Section 4216(b) was amended in 1978 to preclude use of the administratively developed cost-floor alternative as a basis for determining a constructive wholesale price. Pub.L. 95-458, 92 Stat. 1255.[3] In October 1978,

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Sec. 4216(b)(1) of the Code, *as amended* by the Excise Technical Changes Act of 1958, Pub.L. 85-859, §115, 72 Stat. 1275, 1279 (codified as amended at 26 U.S.C. §4216(b)(1) (Supp. V. 1981).

3. Section 4216(b)(1) currently provides:

> (b) Constructive sale price.—
>
> (1) In general.—If an article is—
>
> (A) sold at retail
>
> (B) sold on consignment, or
>
> (C) sold (otherwise than through an arm's length transaction) at less than the fair market price,
>
> the tax under this chapter shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary. In the case of an article sold at retail (other than an article the sale of which is taxable under section 4061(a)), the computation under the preceding sentence shall be on whichever of the following prices is the lower: (i) the price for which such article is sold, or (ii) the highest price for which such articles are sold to wholesale distributors, in the ordinary course of trade, by manu-

Strick filed claim for a tax credit in the amount of $5,046,096, later reduced to $4,758,957, alleging that the cost-floor alternative method of calculation was invalid. Pursuant to section 6416(f) of the Code, Strick took a credit for this amount on excise tax returns filed for the third and fourth quarters of 1978 and the first quarter of 1979. The government has filed a counterclaim for this amount. The amount of the claimed credit represents the difference between the taxes paid from 1972 through the first two quarters of 1978 and the amount that would have been paid if the tax had been calculated on 75% of the established retail price. The district court sustained the taxpayer's claim. The government appeals from this decision.

The district court held that the cost-floor alternative contained in Revenue Ruling 54-61 was invalid because, contrary to the congressional intent that the constructive sales provisions be administered uniformly, the cost-floor alternative puts a high-cost manufacturer such as Strick at a competitive disadvantage. The government contends that Congress never contemplated perfect uniformity in tax liability and intended only to avoid, insofar as possible, inequalities between, manufacturers selling at wholesale and those selling at retail. The government also argues that the taxpayer has not met its burden under section 6416(a) of the Code to demonstrate that it

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NOTE — *(Continued)*

> facturers or producers thereof, as determined by the Secretary. In the case of an article the sale of which is taxable under section 4061(a) and which is sold at retail, the computation under the first sentence of this paragraph shall be a percentage (not greater than 100 percent) of the actual selling price based on the highest price for which such articles are sold by manufacturers and producers in the ordinary course of trade (*determined without regard to any individual manufacturer's or producer's cost*). This paragraph shall not apply if paragraph (2) applies.

26 U.S.C. §4216(b)(1) (Supp. V 1981). (Emphasis supplied).

has not passed along the cost of the allegedly excessive tax to its customers.

The evidence below was as follows: The truck and truck trailer manufacturing industry is highly competitive and sales may be won or lost based on as little as a $50 or $100 difference in the price offered by competitors. Strick incurs higher manufacturing costs than do some of its larger, vertically integrated competitors because Strick purchases many component parts from outside sources. Calculating the excise tax against Strick's already higher costs increases the taxpayer's burden relative to others in the industry. The economic disadvantage created by the cost-floor alternative method is exacerbated when the volume of orders is low. During these periods, the cost per unit rises and so therefore does the excise tax. There was also testimony at trial that audit expenses for a manufacturer paying the excise tax on the cost-floor alternative basis were significantly higher. Strick treats the manufacturer's excise tax as a fixed cost and factors it into the price offered to customers. Customers ordinarily do not inquire into the tax component.

Standard of Review

[1] As the district court recognized, it is settled law that administrative rules contained in treasury regulations are not to be disturbed unless they are plainly contrary to statute. *Commissioner v. South Texas Co.*, 333 U.S. 496, 501, 68 S.Ct. 695, 698, 92 L.Ed. 831 (1948). This deference extends to revenue rulings. *Whattoff v. United States*, 355 F.2d 473, 478 (8th Cir.1966); *Commissioner v. O. Liquidating Corporation*, 292 F.2d 225, 231 (3d Cir.), *cert. denied*, 368 U.S. 898, 82 S.Ct. 177, 7 L.Ed.2d 94 (1961).

[2] In assessing whether a treasury regulation is consistent with the congressional mandate, the Supreme Court has stated that the court must look to whether the regulation harmonizes with the plain lan-

guage of the statute, its origin and its purpose. *National Muffler Dealers Association, Inc. v. United States*, 440 U.S. 472, 477, 99 S.Ct. 1304, 1307, 59 L.Ed.2d 519 (1979). The regulation will have particular force if issued contemporaneously with the governing statute. *Id.* Other relevant considerations are the length of time the regulation has been in effect, the reliance that has been placed on it, the consistency of the interpretation expressed and the degree of scrutiny that Congress has devoted to the regulation during the time it has been in effect. *Id.* These considerations also appear relevant where the challenged administrative interpretation is expressed in a revenue ruling. However, the court recognizes that although a revenue ruling may provide some guidance, it is not entitled to the same deference which is extended to a treasury regulation.

Although Strick emphasizes the competitive disadvantage in which it is placed by virtue of the cost-floor alternative and although the district court made a factual finding to that effect, the issue is whether this competitive disadvantage makes the method plainly contrary to section 4216(b). The parties concede that this issue is purely a question of law and is fully reviewable. *See Joseph Lupowitz Sons, Inc. v. Commissioner*, 497 F.2d 862, 864 (3d Cir. 1974). It is also clear that, despite the rejection of the cost-floor alternative by Congress in 1978, the validity of the ruling must be examined as of the time of its issuance and at each point of significant amendment to the statute thereafter. The legislative history accompanying Public Law 95-458 expressly states that no inference is to be drawn from the amendment "with regard to controversies between taxpayers and the Service concerning either the validity of the cost-floor rule or determinations of cost for taxable transactions which occurred before the effective date of the legislation." S.Rep. No. 95-1127, 95th Cong.2d Sess. 3, *reprinted in* 1978 U.S.Code Cong. & Ad.News 2904, 2907. *See also United States v. Price*, 361 U.S. 304, 313,

80 S.Ct. 326, 331, 4 L.Ed.2d 334 (1960); *F.W. Fitch Co. v. United States*, 323 U.S. 582, 586 n. 2, 65 S.Ct. 409, 412 n. 2, 89 L.Ed. 472 (1944).

Discussion

[3] Based upon a careful review of the prior versions of section 4216(b), the relevant legislative history and the relevant case law, we conclude that the promulgation of the cost-floor alternative was a valid exercise of the Commissioner's discretionary authority under the statute.

We note initially that the plain language of the governing statute expressly grants discretionary power to the Secretary to determine a constructive sales price. Thus, if an article is sold at retail, the tax imposed by section 4061(a) is to be "computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary." 26 U.S.C. § 4216(b)(1) (Supp. V 1981). This discretionary grant may be traced back to section 3441(b) of Chapter 29 of the Internal Revenue Code of 1939, which also provided that in the case of a manufacturer who sold only at retail, the excise tax imposed by the chapter would ". . . be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Commissioner." Internal Revenue Code of 1939, c. 29, § 3441(b), 53 Stat. 1, 416 (*repealed*, 1951). The plain language of the statute, therefore, reveals a consistent and expressly stated congressional policy to accord the Secretary broad discretion in fixing a constructive sales price.

The legislative history of the constructive sales price provision reflects an origin and purpose to create an artificial wholesale selling price for manufacturers who sold only at retail. Because the excise tax is ordinarily levied against the wholesale selling price, a constructive price was needed for manufacturers selling at retail so that the

tax burden on these manufacturers would approximate the norm. *See Continental Truck Industries, Inc. v. United States*, 343 F.Supp. 408, 410-11 (E.D.N.Y. 1972). Thus, the report of the House of Representatives accompanying the Revenue Act of 1932, which first imposed the manufacturer's excise tax, stated:

> It is of utmost importance that the tax be imposed and administered uniformly and without discrimination. Each member of a competitive group must pay upon substantially the same basis as all his competitors, even though his sales methods may differ. Consequently, the bill requires that every effort be made to ascertain the manufacturers' or producers' price at the place of manufacture or production. In the case of those commodities which are ordinarily sold at wholesale, this price will be the price at which the manufacturer sells to the wholesaler, even though the particular sale is at retail. This price may be established with respect to any particular sale or class of sales, for example, by existing wholesale prices, or by a system of discounts from retail prices or by building up from cost of production, whichever method may be the most practical.

H.R.Rep. No. 708, 72d Cong. 1st Sess., *reprinted* in 1939-1 C.B. (Part 2) 457, 480, (Hereafter "1932 House Report").

Section 4216(b) was significantly amended in 1958. A special rule was added to cover the case where a manufacturer sold to the consumer ("at retail") *or to a retailer* in an arms length transaction where sales at retail or to retailers were not the custom in the industry and where the manufacturer had a practice of selling to at least one wholesale distributor in an arms length transaction for prices that were determined without regard to tax benefits. In these circumstances, the manufacturer's excise tax was computed upon the lower of "(i) the price

for which such article is sold, or (ii) the highest price for which such articles are sold by such manufacturer . . ., to wholesale distributors (other than special dealers)." Excise Tax Technical Changes Act of 1958, Pub.L. 85-859, §115, 72 Stat. 1275, 1279 (codified as amended at 26 U.S.C. §4216(b)(2)). Again, the purpose of the amendment apparently was to accommodate the manufacturer-retailer distribution pattern within a statutory scheme which had provided previously only for a manufacturer-consumer or manufacturer-wholesaler pattern of distribution. *See Continental Truck Industries, Inc.*, 343 F.Supp. at 410-11. The legislative history accompanying the 1958 amendments emphasizes the need to equalize, as far as possible, the tax burden between manufacturers choosing the former merchandising method and those choosing either of the latter two. S.Rep. No. 2090, 85th Cong.2d Sess, *reprinted in* 1958 U.S. Code Cong. & Ad. News 4395, 4415 (hereafter "1958 Senate Report").

At the same time, the following sentence was added to section 4216(b)(1):

> In the case of an article sold at retail, the computation under the previous sentence shall be on whichever of the following prices is the lower: (i) the price for which such article is sold, or (ii) the highest price for which such articles are sold to wholesale distributors, in the ordinary course of trade, by manufacturers and producers thereof, as determined by the Secretary. This paragraph shall not apply if paragraph (2) applies.

Excise Tax Technical Changes Act of 1958, Pub.L. No. 85-859, §115, 72 Stat. 1275, 1279 (codified as amended at 26 U.S.C. §4216(b)(1)). This amendment made certain that manufacturers selling at retail who did not qualify under the special rule (as Strick does not) were nonetheless taxed on a constructive *wholesale* price. 1958 Senate Report, *reprinted in* 1958 U.S.Code Cong. & Ad.News 4395, 4418.

This review of the genesis and evolution of section 4216(b) demonstrates that the purpose against which the reasonableness of the cost-floor alternatives must be measured is the effort to approximate a wholesale price for a manufacturer selling only at retail. So viewed, the cost-floor alternative makes the reasonable assumption that a manufacturer will set his wholesale price to recover at least his cost of production. *See Technicolor Motion Picture Corp. v. Westover*, 202 F.2d 224 (9th Cir.1953); *Whattoff*, 355 F.2d at 478. To conclude otherwise would require a finding that it is a general practice for manufacturers to sell below their cost. There is no evidence in the record to support any such conclusion and such a result would clearly be beyond common dealings in the business world. Moreover, the early drafters of the constructive price provision clearly contemplated the possibility of a cost-based method of arriving at the constructive price. Thus, the 1932 House Report stated:

> This (constructive wholesale) price may be established with respect to any particular sale or class of sales, for example, by existing wholesale prices, or by a system of discounts from retail prices, or by a building up from cost of production, whichever method may be the most practical.

1939-1 C.B. (Part 2) 457, 480. The appropriateness of a cost-based constructive price is also mentioned in this report in connection with the special situation of gas and electric companies. 1932 House Report, 1939-1 C.B. (Part 2) 457, 484. Therefore, it appears, at least on a preliminary basis, that the administratively developed cost-floor alternative harmonizes with the origin and purpose of the statute. *National Muffler Dealers*, 440 U.S. at 477, 99 S.Ct. at 1307.

This conclusion is reinforced by consideration of other factors set forth in *National Muffler Dealers*. For example, although not promulgated simultaneously with either the Revenue Act of 1932 or the Internal Rev-

enue Code of 1939, Revenue Ruling 54-61 was issued concurrently with the major revisions to the taxing statutes which occurred in 1954. It is unlikely that the ruling was issued casually or without careful study of the 1932 legislative history. The regulation had been in effect for almost twenty-five years when it was rejected by Congress in 1978. It may be assumed that substantial reliance was placed on it by the IRS and taxpayers alike during that time, since it contained the only specific guide to actually computing the excise tax payable by manufacturers of vehicles who sold at retail. The consistency and deliberateness with which the Commissioner promulgated the cost-floor alternative is also demonstrated by other revenue rulings issued between 1954 and 1978. *See, e.g.*, Rev.Rul. 68-519, 1968-2 C.B. 513; Rev.Rul. 68-202, 1968-1 C.B. 477. Finally, although the ruling was not specifically mentioned by Congress during the 1954-1978 period, it is not unreasonable to assume that Congress became aware of the ruling during the general scrutiny given to the constructive sales price provision in 1958, if not before. Congress did not disapprove the cost-floor method of calculation in the 1958 amendments but rather reaffirmed the Secretary's discretionary authority to determine a fair constructive price. Thus, the sentence added to section 4216(b)(1) provided that in the case of retail sales excise tax would be computed on the lower of "(i) the price for which such article is sold, or (ii) the highest price for which such articles are sold to wholesale distributors, in the ordinary course of trade, by manufacturers or producers thereof, *as determined by the Secretary*." Excise Tax Technical Changes Act of 1958, Pub.L. 85-859, §115, 72 Stat. 1275, 1279 (codified as amended 26 U.S.C. §4216(b)(2) (emphasis added)).

Timing of issuance, durability, reliance, consistency of interpretation and degree of congressional scrutiny all support a conclusion that the cost-floor alternative was not contrary to the congressional mandate during the

1954-1978 period. *See National Muffler Dealers*, 440 U.S. at 477, 99 S.Ct. at 1307.

Strick argues, however, that the manufacturer whose costs are higher than 75% of the retail price of the product will pay a higher excise tax for the same product than the high profit margin manufacturer, *i.e.*, the one whose cost of production is 75% or less than the retail price. Strick contends that this result discriminates against the low-profit margin manufacturer and is contrary to the congressional intent that competitors within industries pay approximately the same amount of tax on the same product.

As can be seen from the legislative history discussed previously, Congress was concerned in both 1932 and 1958 about the uniform application of the excise tax. A similar concern is expressed in the legislative history accompanying the Excise, Estate, and Gift Tax Adjustment Act of 1970, Pub.L. 91-614, § 301, 84 Stat. 1836, 1844, which amended section 4216(b) in ways not relevant here. *See* S.Rep. No. 91-1444, 91st Cong., 2d Sess., *reprinted in* 1970 U.S.Code Cong. & Ad.News 5689, 5708-10. The emphasis, however, was on the need for a constructive pricing system which would be tax neutral with respect to distribution systems. Congress was concerned with uniformity despite sales methods, not uniformity despite costs. The 1958 Senate Report also acknowledges that total uniformity was not possible even with respect to different distribution systems:

> Your committee is in full agreement with the House that substantially different amounts of manufacturers' excise tax should not be imposed with respect to the same type of items merely because one manufacturer chooses to sell his article to a retailer or consumer while the other sells his to a wholesaler. It also recognizes that there are significant administrative problems which make it difficult to achieve a uniform base for purposes of the manufacturers' ex-

> cise taxes. Therefore, your committee has adopted the constructive price provisions of the House bill.

1958 Senate Report, *reprinted in* 1958 U.S. Code Cong. & Ad.News 4395, 4415.

Moreover, in *Fitch Co. v. United States*, 323 U.S. 582, 65 S.Ct. 409, 89 L.Ed. 472 (1945), the Supreme Court rejected a similar attempt to bolster a discriminatory impact claim by reliance upon the same legislative history referred to here. In that case, a manufacturer of cosmetics subject to excise tax argued that advertising and selling expenses were "other charges" within the meaning of section 619(a) of the Revenue Act of 1932. That section excluded from the price upon which the tax was imposed, "[A] transportation, delivery, installation or other charge." One argument made by the taxpayer was that a failure to exclude the cost of advertising and selling expenses discriminated against the manufacturer who did his own selling and advertising and that this result was contrary to the legislative intent. *Id.* at 586-87, 65 S.Ct. at 411-12. Referring to the 1932 House Report, the Court rejected this argument, stating ". . . Congressional statements relating to the desirability of eliminating discriminations against manufacturers making retail sales cannot be taken as evidence of a desire to prevent the natural inequalities that result when a tax is placed on the wholesale selling price." 323 U.S. at 588, 65 S. Ct. at 412. *Accord, Columbia Products Co. v. United States*, 404 F.Supp. 276, 281 (D.S.C. 1975).

The two cases which have considered direct challenges to the cost-floor alternatives set forth in Revenue Ruling 54-61, *Whattoff v. United States*, 355 F.2d 473 (8th Cir. 1966), and *Quaker City Iron Works, Inc. v. United States*, 256 F.Supp. 450 (E.D.Pa. 1966), are divided on the issue of its validity. The case law arising in related areas, however, generally supports a conclusion that the Commissioner properly exercised his statutorily granted administrative discretion in promulgating the cost-floor alternative.

In *Whattoff v. United States*, the operator of a franchised Studebaker dealership became subject to the manufacturer's excise tax when he began modifying Studebaker trucks to enable them to pull mobile homes. The taxpayer challenged use of the cost-floor alternative set forth in Revenue Ruling 54-61 to compute the amount of its liability. The Eighth Circuit rejected the challenge, stating: "Computation of the tax on a basis of the manufacturing cost is certainly reasonable as the fair market price of such manufactured articles is normally the manufacturer's cost plus a profit." 355 F.2d at 478. The court found that the challenged method of calculation "reflects a reasonable implementation of the statute and accompanying regulations." *Id.*

In the contrasting case of *Quaker City Iron v. United States*, the plaintiff taxpayer was a manufacturer of automobile bodies and truck and trailer bodies who sold at retail. During a six-year period, keen competition within the industry forced the taxpayer to offer his products at prices which ultimately resulted in operating losses for each of the six years. The taxpayer challenged imposition of the excise tax during the period based on the cost-floor alternative.[4] The district court stated:

> It is a matter of common knowledge that the price for which articles are sold by a manufacturer is not necessarily higher than the cost of production. There are many instances where a manufacturer will sell items below cost for a considerable period of time in order to maintain his markets or continue business operations in the hope that the market will ultimately swing in his favor.

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4. This is certainly the legal issue addressed and decided by the court. The court states, however, that the IRS, in reliance on Rev.R. 54-61, "refused to allow the plaintiff to use 75% of its retail price as a tax base" and "determined that the plaintiff should pay the tax *based on its full retail price*, since 75% of retail price is lower than cost." 256 F.Supp. at 452-53. (Emphasis added).

256 F.Supp. at 453. The court held that: "When, . . ., the manufacturer lowers his retail price below cost so that, under Revenue Ruling 54-61, he is no longer paying tax upon substantially the same basis as his competitors, the ruling becomes inconsistent with the statute." *Id.* at 453-54. *Whattoff* was distinguished on the ground that there was no showing in that case that sales were made below cost and because there was no established wholesale price for the articles manufactured by the plaintiff in that case. *Id.* at 454. The court also rejected statements in the 1932 House Report to the effect that a constructive sales price might be derived "by a building up from cost." The court was of the opinion that this statement "clearly contemplates a situation where the sales price is above cost." *Id.* at 453 n. 7.

Quaker City Iron Works is factually distinguishable from the instant case in that Strick never actually lost money during the years in question. More fundamentally, however, *Whattoff* and analogous cases offer a more persuasive and carefully reasoned analysis of the issues and legislative history. *Quaker City Iron Works* stands almost alone in rejecting a cost-based method of calculating a constructive sales price. Other cases are generally in accord with the position and analysis set forth in *Whattoff*. *See, e.g., Boise National Leasing, Inc. v. United States,* 389 F.2d 633 (9th Cir.1968) (cost of truck bodies and component parts for taxpayer engaged in rebuilding trucks provides reasonable basis for constructive sales price for excise tax purposes); *Technicolor Motion Picture Corp. v. Westover,* 202 F.2d 224 (9th Cir.1953) (constructive sales price based solely on cost of photographic apparatus designed, manufactured and used by taxpayer approximated fair market price); *Callis-Thompson, Inc. v. United States,* 80–1 U.S.T.C. ¶16,335 (D.Del. March 31, 1980) (cost-plus basis for calculating constructive sales price as set forth in Rev.R. 68–202, 1968–1 C.B. 477, upheld on basis of legislative history, *Whattoff* and *Fitch*); *see also Columbia Products*

Co. v. United States, 404 F.Supp. 276, 280 (D.S.C.1975) (". . . [D]iscrimination against one class of manufacturers or another as the direct result of a particular application of the excise laws is properly the concern of Congress, rather than the courts, . . ."); *Continental Truck Industries, Inc. v. United States*, 343 F.Supp. 408 (E.D.N.Y.1972) (constructive sales price under §4216(b) must approximate wholesale price; 75% of retail alternative set forth in Rev.R. 54–61 nullified by 1958 amendments but cost-based alternative sanctioned by legislative history and case law).

Based on the evolution of section 4216(b)(1), the legislative history and the relevant case law, we conclude that the district court erred in invalidating the cost-floor alternative set forth in Revenue Ruling 54–61. The cost-floor method of calculation represents a reasonable approximation of a wholesale price and is therefore harmonious with the original purpose of section 4216(b)(1). The legislative history of the constructive sales provision indicates that cost-based methods of calculation were expressly contemplated by the drafters of the original provision. Until 1978, the method of calculation was consistently applied by the Commission for many years without any indication of congressional disapproval. A cost-based constructive wholesale price does impose a disparate economic burden on a high-cost manufacturer such as Strick. Obviously, the higher the relative cost or the wholesale price, the higher the tax. That undoubtedly affects the taxpayer's competitive position in a marketplace where competition keeps retail prices relatively uniform. But it is difficult to conceive of any tax that would not have that effect. The same argument could be made against any sales tax: if one's product is higher priced than the competitor, any competitive disadvantage that results is exacerbated by the imposition of a tax based upon price. Ultimately, however, the sometimes harsh consequences of the method of calculation are due to "natural inequalities" which prevent

any system of taxation from being truly uniform. *See Fitch Co. v. United States*, 323 U.S. at 588, 65 S.Ct. at 412. Congress itself recognized that absolute evenness of impact of excise taxes was administratively impossible to achieve. That Congress saw fit to alleviate in 1978 the burden placed on the high cost manufacturer by the cost-floor alternative does not mean that the Commissioner improperly exercised his discretionary authority at the time the Revenue Ruling 54–61 was promulgated. "[T]he views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one." *United States v. Price*, 361 U.S. 304, 313, 80 S.Ct. 326, 332, 4 L.Ed.2d 334 (1960).

The decision of the court below is reversed.[5]

II. THE TAXPAYER'S APPEAL—THE COTGO LEASING ISSUE

In the past, Strick has both leased and sold its products directly to ultimate users. In 1974, Strick's parent corporation, Distribution International Corporation, revived another of its subsidiaries, Cotgo Leasing Co. ("Cotgo") to assume financing and leasing responsibilities for the Strick trailers.

Under the new arrangement, Cotgo purchased the trailers or truck chassis from Strick with money obtained from various lenders under a revolving credit agreement. This agreement required that the price paid to Strick was to be equal to or not more than the price paid in an arms length transaction by a customer of similar size and credit rating. Cotgo then leased the trailers to customers and assigned the leases to the lenders as security for the loan. The lenders also acquired a security interest in the leased trailers or chassis and in Cotgo's

5. Because we determine that the taxpayer is not entitled to a refund, we do not reach the question of whether the taxpayer has complied with the anti-pass-along provisions of section 6416(a) of Title 26.

unleased inventory. Title of the vehicles passed from Strick to Cotgo and remained in Cotgo subject to the security interests of the lenders. The transfer of title was essential to the financing arrangement, since a principal reason for the use of Cotgo as the financing intermediary was to accommodate lenders by isolating the collateral from the claims of other creditors of Strick.

Cotgo has no separate employees, sales force or business location. The officers and managers of Strick handle the business operations of Cotgo, including the leasing of the trailers. Most of the directors of Strick are also directors of Cotgo. Advertising materials put out by Strick advises customers that they can either buy or rent trailers.

Section 4061(a) of the Code imposes a federal manufacturer's excise tax upon the sale of a truck chassis or trailer body. The lease of a trailer or chassis is regarded as a sale for purposes of imposition of the tax, but the manufacturer's liability for payment of the tax in a lease situation arises ratably as payments are made under the lease.[6] A manufacturer's liability also accrues ratably if the transaction is either an installment sale, a conditional sale or a chattel mortgage arrangement.[7] There is

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6. Section 4217 of the Code provides in pertinent part:

> (b) Limitation on tax.—In the case of any lease described in subsection (a) of an article taxable under this chapter, if the tax under this chapter is based on the price for which such articles are sold, there shall be paid on each lease payment with respect to such article a percentage of such payment equal to the rate of tax in effect on the date of such payment, until the total of the tax payments under such lease and any prior lease to which this subsection applies equals the total tax.

26 U.S.C. §4217(b) (Supp. V 1981).

7. Section 4216(c) of the Code provides:

> (c) Partial payments.—In the case of—
>
> (1) a lease (other than a lease to which section 4217(b) applies),
>
> (2) a contract for the sale of an article wherein it is provided that the price shall be paid by installments and

no dispute as to the amount of excise tax which Strick ultimately must pay in connection with the leasing of the trailers; the sole issue is whether the tax must be paid upon the sale or over the term of the lease as payments are received.

Strick argued before the district court that Cotgo should be disregarded as a corporate entity and that Strick should be regarded as the lessor of the trailers for purposes of accrual of excise tax liability. The district court held that Cotgo had insufficient economic substance to be recognized for excise tax purposes and that the transfer between Strick and Cotgo was not a sale. The court then held, however, that the transactions with the "lessees" should be regarded as sales for purposes of imposition of the excise tax. The court therefore denied the taxpayer's refund claim for credit.

Strick seeks a refund of $3,195,591, representing the amount of alleged overpayment of the excise tax, plus interest, during all calendar quarters of 1974 through 1978.

With respect to the question of Cotgo's economic substance, the issue to be determined is whether the rule of law set forth in *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436, 63 S.Ct. 1132, 87 L.Ed. 1499 (1943), is applicable to the facts in this case.

[4] Strick argues that the finding that Cotgo had insufficient economic substance is a factual finding that may not be overturned on appeal unless it is clearly erroneous. Fed.R.Civ.P. 52(a). The clearly erroneous stand-

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title to the article sold does not pass until a future date notwithstanding partial payment by installments,

(3) a conditional sale, or

(4) a chattel mortgage arrangement wherein it is provided that the sales price shall be paid in installments, there shall be paid upon each payment with respect to the article a percentage of such payment equal to the rate of tax in effect on the date such payment is due.

26 U.S.C. §4216(c) (1976).

ard of review does not control, however, when the issue is the applicability of the correct legal standard. *Commissioner v. Danielson*, 378 F.2d. 771, 774 (3d Cir. 1967). If *Moline* applies, the factual finding of the district court was unnecessary.

[5] The taxpayer in *Moline* was the sole shareholder of a corporation which owned real estate. Upon the sale of the property at a profit, the taxpayer sought to have the gain treated as income taxable to him as an individual. The Supreme Court rejected his claim, stating:

> The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity. (Citations omitted). In *Burnet v. Commonwealth Improvement Co.*, 287 U.S. 415 [53 S.Ct. 198, 77 L.Ed. 399], this Court appraised the relation between a corporation and its sole stockholder and held taxable to the corporation a profit on a sale to its stockholder. This was because the taxpayer had adopted the corporate form for purposes of his own. The choice of the advantage of incorporation to do business, it was held, required the acceptance of the tax disadvantages.

319 U.S. at 438-39, 63 S.Ct. at 1133-34 (Footnotes omitted). The continuing validity of the *Moline* doctrine in the income tax area has recently been affirmed by the Eighth and Tenth Circuits. *See Bennett Paper Corporation v. Commissioner*, 699 F.2d 450, 451-52 (8th Cir. 1983); *Crouch v. United States*, 692 F.2d 97, 99 (10th Cir. 1982). *Accord, Collins v. United States*, 514 F.2d 1282 (5th Cir.1975), *aff'g per curiam*, 386 F.Supp. 17

(S.D.Ga. 1974). No cases have been found which have applied *Moline* in the excise tax area.

It is undisputed that Cotgo was established as a separate corporate entity for substantial and legitimate business purposes. Cotgo provided a vehicle which made financing for the production of the trailers more obtainable by isolating the assets which would serve as security for the borrowing. Compliance with the demands of creditors was specifically named by the *Moline* court as one of the useful business purposes for which corporations are formed. 319 U.S. at 438, 63 S.Ct. at 1133. The existence of Cotgo insulated Strick from liability for the repayment of the loans made in connection therewith. Title to the trailers and truck chassis was transferred from Strick to Cotgo in return for full payment from Cotgo to Strick. The legal obligations imposed by the loan documents ran only from Cotgo, not from Strick. Strick did not guarantee payment of the loans. In addition to incurring an obligation for payment of the loans, Cotgo assumed other substantial responsibilities as a debtor under the revolving credit agreement, including the maintenance of a net worth in the minimum amount of $6,000,000 with a stockholders' equity in the minimum amount of $3,000,000. Cotgo entered into numerous leases as a lessor and received rental payments in connection therewith. These facts indicate that although Cotgo had no separate business location or staff, it functioned as a separate and distinct corporate entity in furtherance of a significant purpose which was the equivalent of "business activity."

Strick argues, however, that we should look to the substance of the transactions between Strick, Cotgo and the lessees rather than their form. Strick would have us conclude that, in effect, the trailers were being leased directly from Strick, and that Cotgo was merely being utilized as a conduit. In support of its position, Strick cites several cases and revenue rulings where an affiliated corporation in a position similar to that of Cotgo has been disregarded.

In most of these cases, use of the affiliated corporation conferred an excise tax saving on the manufacturer who was therefore arguing for recognition. In *Ayer Co. v. United States*, 38 F.Supp. 284 (Ct.Cl.1941), for example, the issue was whether sales by a manufacturer of cosmetics were "at retail" for purposes of applying the constructive sales provisions of the excise tax statute then in force. The manufacturing corporation formed a selling corporation to handle the sales of its products. All of its inventory was transferred to the second corporation on credit for an amount equal to the cost of manufacture, plus 15%, plus the amount of the excise tax. The manufacturer sought to have the tax levied against this price, which was less than the constructive sales price that would have been imposed by the Commissioner. Because the selling corporation had no capital, no separate business location and shared employees, managers and directors with the manufacturing corporation, the Court of Claims found that the selling corporation was a mere shell. 38 F.Supp. at 288. The court held that sales to the public by the selling corporation would be regarded as retail sales by the manufacturing corporation and that the constructive sale price provisions of the Commissioner would apply. *Id.*

In *Kin-Septic v. United States*, 64 F.Supp. 142 (Ct.Cl.1946), the owner of a cosmetics manufacturing corporation set up a distributing corporation which assumed responsibility for the packaging, shipment and sale of the manufacturer's products. The manufacturer sought to have the tax assessed against the price it charged the affiliated corporation. Relying on *Ayer*, the Court of Claims found that "the primary purpose of the new arrangement was to reduce the amount of the tax" and imposed the tax payable by the manufacturer had it sold directly at retail. *Id.* at 148.

Most of the revenue rulings relied on by the taxpayer essentially replicate these holdings or involve minor variations. *See, e.g.*, Rev.Rul. 59-163, 1969-1 C.B.

353; Rev.Rul. 62-68, 1962-1 C.B. 216, Rev.Rul. 75-130, 1975-1 C.B. 347.[8] In each of these cases and rulings, the finding that no sale had occurred between the manufacturer and the distributing corporation was a necessary preliminary to the imposition of tax liability on the manufacturer on the basis of a constructive sales price. For the most part, the holdings of these authorities are consistent with the recognized exception to the *Moline* rule that the Commissioner may disregard the corporate form in order to avoid a fraud on the taxing statute. *Moline Properties*, 319 U.S. at 439, 63 S.Ct. at 1134. Here the issue is whether the manufacturer should be taxed all at once or ratably.

Rev. Ruling 59-299, 1959-2 C.B. 253 provides the strongest support for Strick's position. In this ruling, the IRS considered transfers between a company which manufactured trailers taxable under section 4061(a) and a leasing company where (1) both companies were owned and operated by the same individual and where (2) both companies were owned by the same partners. It held that the transfers were not sales but that the manufacturer would be liable for excise tax upon lease of the trailers. This ruling is not cluttered by considerations of shifting functions in an effort to lower the tax. Rev.Ruling 59-299 is distinguishable, however, because in the one case the companies were sole proprietorships operated by the same individual and in the second case, the companies were operated by partnerships with common partners holding identical interests in both. The

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8. Rev. Ruling 67-209, 1967-1 C.B. 297, also relied on by the taxpayer, held that where the subsidiary of a foreign manufacturer of goods transmitted orders and received goods through an independent corporation which cleared the goods through customs, the substance over form rule would be applied to hold the subsidiary, and not the independent corporation, liable for excise taxes imposed upon an importer of goods. The issues and relationships discussed in this ruling do not illuminate the present problem before the court.

ruling is expressly grounded on the principle that "a person may not sell to himself." In the present instance, the affiliated entities and the common parent are all corporations which are generally recognized as separate taxable entities. *See Moline Properties*, 319 U.S. at 438-39, 63 S.Ct. at 1133-34.

Strick argues that the revenue rulings upon which it relies indicate that a practical and flexible view of corporate structures prevails in the excise tax area. We are convinced, however, that results reached in these authorities further the congressional purpose of preventing manufacturers from avoiding constructive sales price provisions by selling to the ultimate consumer through a related corporation or from reducing their excise tax liability by charging lower prices to related buyers. *See Creme Manufacturing Co. v. United States*, 492 F.2d 515, 519 n. 4 (5th Cir.1974); Rev. Ruling 62-68, 1962-1 C.B. 216. None of the cases or other authorities relied on by Strick considered issues related to the timing of a manufacturer's excise tax liability when a related corporation is used to assume financing obligations.

The position of the government is essentially that the *taxpayer* may not have a legitimately established corporation disregarded in order to obtain a tax advantage. In addition to relying on *Moline*, the government points out that this court recognized the appropriateness of a similar double standard in *Commissioner v. Danielson*. In that case, a taxpayer appealed the tax consequences of a contractual allocation of the purchase price of a business. We commented:

> Next, we are not here involved with a situation where the Commissioner is attacking the transaction in the form selected by the parties, *e.g.*, *Schulz v. C.I.R.*, 294 F.2d 52 (9th Cir. 1961). Where the Commissioner attacks the formal agreement the Court involved is required to examine the "sub-

> stance" and not merely the "form" of the transaction. This is so for the very good reason that the legitimate operation of the tax laws is not to be frustrated by forced adherence to the mere form in which the parties may choose to reflect their transaction. *Gregory v. Helvering*, 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596 (1935); *C.I.R. v. Court Holding Co.*, 324 U.S. 331, 65 S.Ct. 707, 89 L.Ed. 981 (1945). In contrast, the Commissioner here is attempting to hold a party to his agreement unless that party can show in effect that it is not truly the agreement of the parties. And to allow the Commissioner alone to pierce formal arrangements does not involve any disparity of treatment because taxpayers have it within their own control to choose in the first place whatever arrangements they care to make.

378 F.2d at 774-75. Underlying the decision in *Danielson*, however, were policy considerations such as the desire to avoid a unilateral reformation of a contract, possible unjust enrichment of one of the parties to the contract and a concern for predictability in allocating the tax consequences in the sale of a business. *See Sullivan v. United States*, 618 F.2d 1001, 1004 (3d Cir. 1980). These policy considerations are not present here.

The Second Circuit has taken the position in reviewing organizational patterns chosen by corporate families that "whether probing form for substance leads to a decision favorable to the Government or to the taxpayer is immaterial . . . ." *Hoffman Motors Corporation v. United States*, 473 F.2d 254, 257 (2d Cir. 1973). *See also Cleary v. United States*, 232 F.Supp. 828, 830 (W.D.Pa. 1964).

We conclude, however, that in this case the taxpayer should be bound by the form in which it has chosen to conduct its business. Substantially all of the authorities relied on by Strick involved an attempt to

avoid taxes, in effect finding that the arrangement on paper was a sham and should not be utilized to avoid the normal tax consequences of the transaction. Here, having chosen to do business as separate entities, certainly Strick and Cotgo should be estopped from contending that their relationship was a sham and that they should be treated as one and the same. The taxpayer cannot now claim that it is entitled to all of the benefits but not the normal tax detriments that flow therefrom. *See Bennett Paper Corporation*, 699 F.2d at 451-52.

The circumstances which permit the Internal Revenue Service to look to the substance rather than the form of a transaction in order to seek payment of taxes which would otherwise be due but for the form, does not require the mutuality that Strick contends. The government has the right to claim that the form of a transaction should not be utilized to postpone taxes that are otherwise due. The taxpayer does not have the like right to contend that the form that it has chosen should be ignored so that avoidance or postponement of the tax can be accomplished. No such mutuality of remedy is or should be required.

Even if we were to accept the taxpayer's invitation to focus on the substance of the relationships here rather than the form, the substance of the corporate structure and financing arrangements entered into by Strick and Cotgo allowed Strick to receive the benefit of financing its manufacturing operations with borrowed money without incurring any of the obligations normally incident to such borrowing. The obligations for which the trailers were security were the responsibility of Cotgo alone. Strick's argument that it was in effect the borrower flies in the face of the legal import of the loan documents which obligate only Cotgo. "[A] transaction is to be given its tax effect in accord with what actually occurred and not in accord with what might have occurred." *Commissioner v. National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 148, 94 S.Ct. 2129, 2137,

40 L.Ed.2d 717 (1974). In return for full payment, Strick transferred title and control. Thus even if the court accepts the substance over form argument of Strick, these facts indicate that the separation between the two corporations and the transfers between them had significant economic consequences and were not merely a matter of form.

The full payment received by Strick when it transferred title to Cotgo is crucial in another respect. If we view the subsequent leases as the only operative transaction, Strick's liability will arise only ratably. 26 U.S.C. §4217(b). Strick would thus receive a bonanza through a combination of full payment and deferred taxation. Although we have found no legislative history or cases which discuss the purpose of the deferred payment provision, the apparent purpose was to alleviate a cash flow hardship for the manufacturer, not to confer a windfall.

There is no dispute in the record that Cotgo was established to facilitate the financing of production of the Strick vehicles. The district court so found. Organizing one's business in order to comply with the requirements of lenders is a legitimate business purpose under *Moline*. 319 U.S. at 438, 63 S.Ct. at 1133. There is also no dispute that Cotgo engaged in business activity in furtherance of the purpose for which it was established. We find therefore that *Moline* is applicable to the facts of this case and that Cotgo must be recognized as a separate entity for excise tax purposes. We are not bound by the factual determination of the district court that Cotgo had insufficient economic substance to be recognized for excise tax purposes because the district court failed to apply the applicable legal standard. *Commissioner v. Danielson*, 378 F.2d at 774. We conclude that the sale of the truck and trailer chassis to Cotgo was the taxable event under section 4061(a). Strick's liability for payment of the manufacturer's excise tax arose in full at that time. Because the taxpayer paid the tax on this basis

originally, the denial of the court below of the taxpayer's refund claim will be affirmed.[9]

For the foregoing reasons, the portion of the judgment from which the taxpayer appeals will be affirmed, and the portion of the judgment from which the government appeals will be reversed.

9. Because we determine that the liability of Strick for excise taxes must be decided on the basis of the first transfer of vehicles between Strick and Cotgo, we do not reach the issue of whether the district court erred in recharacterizing the transactions with the lessees as sales.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 82-1272
No. 82-1273

STRICK CORPORATION,
Appellant/Cross Appellee

v.

UNITED STATES OF AMERICA,
Appellee/Cross-Appellant

(D.C. Civil No. 80-1433 — E.D. Pa.)

SUR PETITION FOR REHEARING

PRESENT: SEITZ, *Chief Judge*, ALDISERT, ADAMS, GIBBONS, HUNTER, WEIS, GARTH, HIGGINBOTHAM, SLOVITER, BECKER, *Circuit Judges*, and SAROKIN, *District Judge.**

The petition for rehearing filed by appellant in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the

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* Honorable H. Lee Sarokin, United States District Judge for the District of New Jersey, sitting by designation.

circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By the Court,

Collins J. Seitz
Chief Judge

Dated: November 7, 1983

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 82-1272/73

STRICK CORPORATION,
Appellant in 82-1273

vs.

UNITED STATES OF AMERICA,
Appellant in 82-1272

(D.C. Civil No. 80-1433)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Present: SEITZ, *Chief Judge;* SLOVITER, *Circuit Judge;* Sarokin, *District Judge.**

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel on June 9, 1983.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, entered March 8, 1982, be, and the same is hereby affirmed with respect to that portion of the judgment from which Strick Corporation appeals and re-

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* Honorable H. Lee Sarokin, United States District Judge for the District of New Jersey, sitting by designation.

versed with respect to that portion of the judgment from which the United States appeals. Costs taxed in favor of the United States.

ATTEST:

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Clerk

Dated: August 2, 1983